



# TEXAS ALCOHOLIC BEVERAGE COMMISSION

*Texans Helping Businesses & Protecting Communities*

P.O. Box 13127  
Austin, Texas 78711-3127  
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[www.tabc.texas.gov](http://www.tabc.texas.gov)

November 24, 2020

The Honorable Tracy O. King, Chair  
The Honorable Craig Goldman, Vice Chair  
Committee Members  
House Licensing and Administrative Procedures  
Capitol Building, Room E2.156  
Austin, TX 78701

Dear Chair King, Vice Chair Goldman, and Committee Members:

The Licensing and Administrative Procedures Committee requested information pertaining to Interim Charge 3. Enclosed is a detailed response from the Texas Alcoholic Beverage Commission, including a summary of control labels defined in Code, how they impact the alcoholic beverage industry in Texas, and considerations for modernizing how the agency regulates them.

***Interim Charge 3:*** *Examine "control label" products and their impact on the three-tier system and alcoholic beverage industry in the state. Make recommendations to regulate control label products in a way that promotes economic growth, benefits the consumer, and stabilizes the three-tier system.*

## **Summary of Control Labels defined in Code**

The Alcoholic Beverage Code is built on the three-tier system of regulation, which mandates the separation of the industry into three tiers: Manufacturers (e.g., breweries), retailers (e.g., liquor stores), and the distribution tier that buys product from manufacturers and sells it to retailers.

Without the three-tier system, the industry would vertically integrate so that one tier would absorb the other two. The result would be monopolization of the industry, boxing out independent operators. Historically, vertical integration enabled the large manufacturer to control the retail tier, leading to permanent indebtedness that fostered overconsumption and its consequences. The three-tier concept was designed to prevent this, and it became the most common form of regulation following the repeal of Prohibition. However, the landscape has shifted since then. Due to their enormous purchasing power, modern retail chains exert control over manufacturers and wholesalers.

A control label is a product made by a manufacturer exclusively for a (typically large) retailer. Because of its purchasing power, the retailer can force the wholesaler to sell the product exclusively to that retailer at a low cost. The retailer can then sell its store brands at a low cost to the detriment of other manufacturers' products.



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The Code prohibits these arrangements. Chapter 102 of the Code is titled “Intra-Industry Relationships” and governs the interactions between the three tiers. While no provision explicitly addresses control labels, several provisions nonetheless prohibit these arrangements. Exclusivity arrangements are considered unlawful. In addition, the discounted price that the retailer can demand for the control labels are prohibited.

The challenge is that thousands of these products are already in the Texas marketplace. The Code forces TABC to approve a label application for any wine or hard liquor product that has already received federal approval. In contrast, beer label applications undergo TABC scrutiny. Hence, while we have successfully kept beer control labels out of Texas, thousands of wine and liquor products remain. We do not believe that TABC has the discretion to interpret the current Code in a way to authorize control labels.

Any fix will require statutory changes, and there are several ways to do that. One approach would be to create a subsection within Chapter 102, requiring TABC to develop rules addressing the control label issue:

Sec. 102.011. RETAILER EXCLUSIVE WINE AND LIQUOR BRANDS. The commission shall adopt rules regulating the production, importation, and sale of retailer-exclusive wine and liquor brands.

The benefit in this example grants the commission broad latitude to regulate control labels. That comes with a downside — the Legislature may not like what the commission adopts. For instance, the commission theoretically could promulgate rules that expressly prohibits the production and sale of control labels.

Another approach would be to expressly authorize control labels while giving TABC rulemaking authority to sort out the details:

Sec. 102.011. RETAILER EXCLUSIVE WINE AND LIQUOR BRANDS.

- (a) Notwithstanding any other provision of this code and subject to the rules of the commission, the holder of a winery permit, a distillery permit, or a non-resident seller’s permit is authorized to manufacture liquor products for sale to a single retail permit or license holder.
- (b) The commission shall adopt rules to implement this section.

The benefit of this version is that the control label practice is expressly authorized. However, this version leaves out the middle tier. To preserve the three-tier system, the approach below includes all tiers.

Sec. 102.011. RETAILER EXCLUSIVE WINE AND LIQUOR BRANDS.

- (a) Notwithstanding any other provision of this code and subject to the rules of the commission, the holder of a winery permit, a distillery permit, or a non-resident seller’s permit is authorized to manufacture liquor products for sale to a single retail permit or license holder.



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- (b) A manufacturer that produces a product authorized under subsection (a) must enter into an exclusivity agreement with a wholesaler. The parties must submit the exclusivity agreement to the commission for review and approval.
- (c) The commission shall adopt rules to implement this section.

The Texas Alcoholic Beverage Commission appreciates the opportunity to provide this valuable information to the committee. We look forward to our continued efforts in effectively regulating all licensed businesses in the alcoholic beverage industry and protecting the public's health and safety.

Sincerely,

A handwritten signature in black ink, reading "A. Bentley Nettles". The signature is fluid and cursive.

A. Bentley Nettles  
Executive Director  
Texas Alcoholic Beverage Commission